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BEFORE THE

SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

VERIFIED COMMENTS OF
FINGER LAKES RAILWAY CORP.

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Dated: May 15, 2000

Attorneys for Finger Lakes Railway Corp.

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Finger Lakes Railway Corp. is filing these comments in response to the Advanced Notice of Public Rulemaking ("ANPR") served by the Board on March 31, 2000. In the ANPR, the Board requested comments on whether it should amend its regulations governing major rail consolidations. FGLK welcomes the opportunity to present its views to the Board.

Summary of Comments

The comments of FGLK are set forth in full in the verified statement of Michael V. Smith attached hereto. In general, FGLK believes that mergers should be structured not only to preserve competition but to promote it. In FGLK's view, the best way for this goal to be achieved is through private negotiations, and not imposed by regulations. The Board has often recited a similar preference. However, in order for parties to be able to negotiate, they need to fully understand what the issues are. Thus, FGLK believes that instead of adopting new fixed conditions, the Board should instead require realistic, specific disclosures by applicants of how the different relevant issues will be handled by them. Parties can then reach accommodations, or in the absence of such accommodations the Board can weigh the applicants' proposal to see if on balance it promotes the public interest by promoting competition.

FGLK addresses a number of issues that impact on mergers and how they are carried out, and thus how they should be considered by the Board. Most importantly, FGLK discusses the following issues:

Merger Review Team. FGLK believes that the Board's review of an application would be enhanced by the appointment of a "Merger Review Team" made up of experts and shipper, short line and government "stakeholders." Their role would be to carefully review the applicants' merger plan and to advise the Board of their findings.

Promoting Competition. The potential pro-competitive measures suggested by the Board in the ANPR should be addressed; however, it should be left to the applicants in the first instance as to how they wish to address the issues. The remedies suggested by the Board in the ANPR should not automatically be imposed, but rather should be imposed as conditions only after a review of all the steps taken by applicants to enhance competition.

Safeguarding Rail Service. Maintaining quality of service after a merger is of extreme importance, and thus the proposed operating plans of the applicants must be closely examined. The applicants should have to provide in their operating plans detailed mean transit times both pre- and post-merger. These would act as benchmarks to determine if there are "service failures" that need to be addressed.

The operating plan must also be examined to determine if the applicants have adequately provided for the necessary infrastructure improvements, the equipment necessary to handle projected traffic levels, and sufficient and capable staffing.

Shortline and Regional Railroad Issues. FGLK believes that the applicants should be required to address each of the issues raised by the ASLRRA's "Bill of Rights," and that they should be considered as conditions in each merger depending on the circumstances.

Conclusion

For the reasons set forth above and in the attached verified statement, FGLK requests that the Board revise its regulations as suggested.

Respectfully submitted,

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VERIFIED STATEMENT OF
MICHAEL V. SMITH

My name is Michael V. Smith. I am President of Finger Lakes Railway Corp. (FGLK). Prior to becoming the President of FGLK, I served for over 35 years in various capacities at both large and small railroads, and as an independent consultant to the industry. I am authorized to present these comments to the Surface Transportation Board (Board) on behalf of FGLK.

Background

FGLK is a shortline operator that leases 118 miles and operates 154 miles of lines (including operating rights) within New York State. A map of FGLK is attached as Exhibit A. FGLK was formed in 1994 to acquire the lines from Conrail.[1] At the time, its sole connection was with Conrail. As a result of the Conrail control transaction, FGLK now has interchange connections with Norfolk Southern Corporation (NS) at Geneva, NY and CSX Transportation Inc. (CSXT) at Lyons and Solvay, NY. In 1999, FGLK handled 10,495 carloads, most of which were dependent upon interchange with its two connecting Class I service partners.

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[1] Because of the property tax scheme in New York State, the lines were actually purchased by a group of county IDAs who entered into lease arrangements with FGLK.

Comments

The Board has asked for comment in several areas related to railroad consolidation that would be categorized as major transactions under 49 CFR 1180.2. FGLK strongly believes in the fundamental premise that a free and open marketplace should determine the shape and future of North American railroading. Government imposed rules and regulations should be kept to the absolute minimum. Notwithstanding, the Board has an obligation under 49 U.S.C. 11324 to consider the public interest in addressing rail mergers taking into account, at a minimum, adequacy of transportation to the public; including other rail carriers in the area involved; competitive effects; financial impacts on the involved carriers; and impacts on employees. In addition, the rail transportation policy outlined in 49 U.S.C. 10101 requires the Board to consider safety, efficiency, good working conditions, and an economically sound and competitive rail transportation system, and the needs of the public and the national defense.

FGLK therefore feels that the merger consideration process of the Board should be thorough and complete so that, upon approval by the Board, a merger transaction can go forward unencumbered by further regulation. Simplified, the merger assessment process has consisted of filing by merger applicants followed by consideration of protestant and public comment issues, with the Board making a final determination of the conditions for transaction approval. For the most part, the Board decisions have been based on the good faith representations of the parties. This methodology continued that of the predecessor Interstate Commerce Commission (ICC), and the Board had no reason to believe that the same process would not work going forward.

Had transitions in the latest round of Class I mergers[2] gone well, there would likely have been no need for the Board to consider changes in its merger guidelines. Additionally, "downstream" effects, and the potential responses of other carriers, were not considered by the ICC and may have induced illogical merger combinations in the past. Given these factors, the Board is presented with the opportunity to re-shape merger policy based on past experience and current economics.

In the Conrail partitioning transaction under FD 33388, FGLK believes that the applicants were sincere in their plans to accomplish a smooth transition. We also believe that the Board made a comprehensive review of the transaction and that it received a general acceptance by the public for approval, as it would establish rail competition at many locations where none existed previously. FGLK also witnessed very visible signs of significant planning leading to the start-up; yet, both carriers have suffered service disruptions that continue to impact FGLK's customers and business levels. Indeed, in all of the latest mergers, the applicants indicated that numerous special precautions and backup plans were in place to ensure smooth transitions. Despite extensive planning, significant and pervasive service problems still occurred.

FGLK believes that for future merger considerations the Board should adopt new requirements that will apply to a proponent's merger application under 49 CFR 1180.2. The requirements would reflect those elements that the Board feels are of sufficient and compelling public interest to be specifically addressed by the merger proponents. A merger application received by the Board that specifically addresses those requirements would be a complete document from which the Board could logically proceed on the individual merits of the proposed

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[2] These would include UP/CNW, UP/SP and CSXT/NS/Conrail.

transaction. The issuance of hard rules and regulations relative to what carriers can or cannot do can lead down a road of unintended consequences. We believe with the view often recited by the Board that private sector negotiation and agreement still prevail as the best avenues for issue resolution.

Merger Review Team

The Board's review of mergers should be conducted in greater depth and detail. FGLK suggests that the Board designate a Merger Review Team that would be activated upon the filing of a Notice of Intent for a major railroad merger transaction. The review team would be composed of Board appointed railroad experts (paid for by the applicants) and "stakeholder" representatives such as a shipper, shortline and regional railroads, government, or such other representatives as the Board deems necessary.[3] The function of the review team should be to perform an <u>on site</u> "due diligence" of the proponent's merger plan as deemed proper by the Board. The review team would have no power to alter, negotiate, or otherwise revise any part of the merger plan, but would report its findings to the Board as to the ability to implement the plan outlined in the proponents' application.

In developing merger applications, senior management must consider the best strategic and tactical options to ensure company survival. There is also the responsibility to ensure that the company maintains its competitive position. Merger is one tool available to ensure such survival. Of equal importance is the ability of functional managers to fully

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[3] The Board has used advisory councils in other contexts. For example, in the CSXT/NS/Conrail transaction, a "Conrail Transaction Council" was appointed after the transaction was approved to review the planning for the split, and the implementation of the transaction.

understand the objectives and magnitude of the merger integration and implementation process. This is why FGLK believes that a Merger Review Team is necessary to make sure that the understanding of the merger implementation is complete at all levels of company management.

Formation of a review team, upon filing of the Notice of Intent, would provide the Board with adequate time to assemble expertise and begin its review on the day the application is submitted to the Board. FGLK believes that the review should run concurrent with the present one-year schedule that the Board has used in considering previous applications, and that the review by the Merger Review Team should be completed within 180 days of the applicants' submission.

Promoting and Enhancing Competition

The Board has asked for public comment on whether competition-enhancing measures should be considered for incorporation into the Board's merger rules. While FGLK believes that many of the pro-competitive actions suggested in the ANPR should be considered as conditions in a specific merger, it does not believe that they should be imposed as absolute pre-conditions for every merger.

The purpose of Board issued merger requirements is to ensure that the proponents submit an application that is complete "up-front" in addressing all of the relevant issues. Other issues will surface during protestant and public comment filings. The requirements ensure that the merger proponents have completely addressed the "macro" issues regarding their application.

As part of the process it is important for all parties to know if and how the applicants are willing to promote the public interest through competition-enhancing measures. To a great extent, applicants already anticipate competitive issues in their filing. For example, in the Conrail transaction, the proponents knew that for the transaction to be approved, it would have to pass public and Board scrutiny with respect to competition. This, no doubt, is why they developed the so-called "Shared Asset" areas in their proposals. In addition, there were numerous other agreements reached relative to switching zone access, as well as access to other Class I carriers and shortlines, regional railroads and operations within municipalities. All of these actions represent the private sector at work, which we believe is the best way to define the nature and shape of the future railroad competitive playing field.

Current regulations already require a significant amount of information. (The CSXT/NS/Conrail application filled 7 volumes.) However, much of the information is difficult to decipher and/or difficult to locate. In order to ensure that all relevant issues are addressed by applicants in a useful way, the Board should set forth specific issues that should be addressed in separate easily identified sections.[4] In this way, parties would better be able to see how they will be treated, and will better be able to address their issues in private negotiations with the applicants, or if necessary, with the Board. Further, depending on the responses, the Board could weigh whether the overall application is providing sufficient public benefits to be approved.

In fact, all of the rule proposals on which the Board has asked for comment in this proceeding could be posed as required elements to which the merger applicants must respond. For example, topics to be addressed could specifically include:

- What specific benefits do the applicants expect to derive from consummating the proposed transaction, and what benefits are in the public interest?

[4] The Board has recently complained about how difficult it can be to work through masses of poorly referenced work papers and electronic files. FMC Wyoming and FMC v. Union Pacific Railroad, STB Ex Parte No. 346 (Sub-No. 29A), Decision (served May 12, 2000), at 38.

- How do the applicants intend to protect customers and shortline railroads from merger-related service disruptions, and the loss of adequate infrastructure and capacity?

- What performance standards do the merger applicants intend to meet, and what is the service integration plan detail?

- How will the applicants approach gateway issues for all major routings?

- To what extent does the merger applicants' proposal provide switching, at agreed-upon fees, to all exclusively served shippers located within or adjacent to terminal areas?

- How will the applicants approach the competitive portion of joint-line routes when the joint-line partner has a bottleneck segment?

- How will the applicants handle routing at a reasonable interchange point whenever they control a bottleneck segment and the shipper has entered into a contract with another carrier for the competitive segment?

- How will the applicants provide an exclusively served shipper with access to an additional carrier where the solely serving carrier is merging with one of several connecting carriers?

- What is the applicants' policy with respect to compensation of shippers and shortlines for demonstrable costs of service failures?

- What interchange and routing freedoms will the applicants grant shortline and regional railroads?

- What is the applicants' policy with respect to so called "paper" and "steel" route barriers in connection with shortline and regional railroads?

- What steps have the applicants taken to assure competitive and nondiscriminatory pricing with respect to shortline and regional railroads?

- What is the applicants' policy with respect to nondiscriminatory car supply involving shortline and regional railroads?

- How will the applicants deal with post-merger changes in collective bargaining agreements and/or expanded labor protection?

- How will merger applicants handle those situations where the number of rail carrier alternatives within a corridor would be reduced by this merger from three to two?

- To the extent the proposed merger involves cross-border parties, how will the applicants address adequacy, consistency, and effectiveness of extra-territorial oversight, safety matters, national defense implications of foreign control of a large U.S. railroad, impacts on U.S. ports and waterway systems, and impacts on U.S. grain and lumber interests?

- Does adequate car supply exist to support the projected business volumes of the applicants' plan?

There may well be others that will be raised by participants in this proceeding.

Price Competition and Competitive Harm

Defining competitive harm is like trying to get your arms around a "greased pig". It is both difficult and messy. The Board and its predecessor, the Interstate Commerce Commission, have been "refereeing" competitive disputes between shippers and railroads for years and desperately striving to allow marketplace resolution without government imposed solutions. Currently, by statute, a railroad does not dominate a market if its revenue is less than 180 percent of its variable costs for transporting a shipper's commodities.[5] To an extent, this sets the parties on a collision course in the dispute of proving whether the 180 percent threshold is met, when the real question at hand is one of fairness. In the merger context, FGLK believes the Board should rely, to a large extent, on carrier and shipper practices as a determinant of whether fair competition exits. The following two examples illustrate this point:

(1) It is not uncommon for rail carriers to offer shippers multi-year contract pricing at either a fixed term price or a fixed percentage of annual increase. The shipper has the right, at that time, to accept or reject the carrier's terms based on the competitive options it has at hand or foresees.

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[5] 49 U.S.C. 10707(d)(1)(A).

If the shipper accepts the terms, the rate is fixed for the contract period. If the proposal is rejected, then the shipper is at risk for the future. If a year later the carrier decides to increase the shipper's price for an otherwise reasonable cost recovery increase, the shipper should have no standing before the Board to dispute the carrier's increase.

(2) Similarly, if a carrier is offering prices and services into the market, and refuses to offer the same price under the same conditions to other market participants (shippers, shortlines, etc.) those parties should have standing before the Board for review and remedy of these carrier practices.

The two examples above operate absent the 180 percent revenue to variable cost test threshold. FGLK believes that the focus has been too much on the threshhold, when the real concern should be competitive non-discriminatory pricing. Ultimately it comes down to the value received by customers for services at a price, and the fairness in which those services are offered by carriers into the marketplace. It is this fairness that should be the subject of the Board's focus in merger proceedings, and in the relief that it grants..

Open Gateway Access, Switching, Interchange and Routing Alternatives

The Board has asked for comment on the imposition of merger rules that would require expanded competitive access alternatives for shippers under a proposed major merger transaction. Again, FGLK feels that the best course for the Board to follow is to ensure these elements are fully addressed in its requirements and guidelines for submission of applications.

The Board could impose access to a second carrier to promote competition. However, allowing the access does not, of itself, assure that the carrier will use the granted access if viewed as cost prohibitive. In addition, there may be safety and operational concerns that could make the use of the granted access difficult. For example, line capacity issues, train-dispatching issues (obtaining a time window to operate on the track), and who performs and how much is paid for track maintenance. Also, there is the geographic issue of how easily the shipper can be accessed. It is one matter of cost if the company is located on a main right-of -way or proximate to the interchange, but totally different cost if the company is the lone customer located 15 miles out on an irregularly used branch line.

An alternative to second carrier access would be a review of the commodity pricing structure of the merger proponents. If a customer would be materially affected, the merger proponent would allow the affected shipper to connect to a competing carrier at a logical location at a price that was comparable to what is customarily charged for the same commodity and distance elsewhere on the merger proponent's system. This is using a "customs and practices" approach to a solution which, in its aggregate, is market based, and it takes into account how the carrier responds to market pricing for the same commodity at other locations on its system. This then removes the need for a competing carrier to physically serve the affected customer directly.

FGLK believes the fundamental issue with respect to inter-railroad competition is whether a shipper has a second viable rail alternative for the routing of its freight. Of particular concern to a shipper in any railroad merger is going from two carriers down to one. Shippers often make choices concerning the location of plant facilities based on competitive rail alternatives, and an argument could be made that loss of a competing rail service choice could be detrimental to a community or region. FGLK suggests that the Board should specifically require merger proponents to describe how they will accommodate these situations.

Inevitably there will be some disputes where the fervor of the parties is such that they cannot agree, and the Board and / or the court system will be called upon to adjudicate the matter. Nonetheless, if the number of such cases can be minimized, then the public interest will be served.

Three-to-Two Issues

Three-to-two issues are less likely to be a major issue in many sections of the country because of the consolidation of Class Is that have already taken place. Further, three-to-two issues are far less of a competitive concern than a two-to-one problem. However, the Board should examine in such situations how active the competition has been, and whether the non-merging carrier has been an active participant in the market. The Board has stated, "We recognize that the Government is not in the business of drawing railroad maps, and we are not attempting to do so in this proceeding. We are also aware that the law that we administer generally contemplates private initiatives that are then subjected to regulatory scrutiny."[6] Shippers that have such options would be at risk of losing a valuable competitive alternative. Again, this is an example of where the Board should require the merger proponents to specifically address how these situations will be handled in their merger application. The Board should then consider the proposed or other available remedies in its consideration of the application.

"Downstream" Merger Effects

FGLK recommends that the Board consider the downstream effects in its merger considerations including the likely response of other carriers to the proposed merger at hand.

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[6] Public Views on Major Rail Consolidations, STB Ex Parte No. 582, Decision (served March 16, 2000), at 2-3.

Each merger application filed with the Board will have a totally different set of downstream impacts. The players, nature and scope of any proposed merger must be known before consideration can be given to the downstream effects. Among those elements are:

- Who are the merging parties?
- Is the structure of the merger end-to-end or parallel?
- What are the particular benefits and obstacles associated with the proposed combination?
- Will it involve international interests and issues?

To attempt the creation of specific rules that apply to all mergers going forward will be difficult. FGLK recommends that merger proponents be required as part of the merger requirements to succinctly quantify the benefits of its proposed combination and the resulting public benefits, and how those may be affected by likely subsequent response. We believe the Board should then encourage the public to comment specifically on the anticipated downstream effects of the proposed merger in that phase of its merger consideration. Downstream impacts can be both positive and negative, and the merger proponents should be provided an opportunity to respond to such public comments. In the end, the Board will have to decide, on the weight of evidence, to what extent downstream effects will affect its decision.

Safeguarding Rail Service

In April 1999, the General Accounting Office completed a report to Congress: "Changes in Railroad Rates and Service Quality Since 1990."[7] One of the principal findings in this report was that "quality of service currently cannot be measured." Changes in Railroad

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[7] Chapter Report, 04/16/99, GAO/RCED 99-93.

Rates, Chapter 0:4.3. There is an old saying, "you cannot improve what you cannot measure." We think that applies here.

FGLK believes that the Board should require future merger filings to contain service-benchmarking standards. The operating plans of merger filings typically identify service components such as schedules between yard points, expected terminal dwell times, etc. For the most part, this is irrelevant information. What customers want to know is: "When I drop my package off, when will it be delivered?" Accordingly, the Board should at minimum require:

- Merger proponents to identify the mean transit time that exists pre-merger on a major city basis, including connecting shortlines, individually by traffic sectors (intermodal, merchandise and unit train rail car business), and proposed post-merger mean transit times.

- Service between major yard terminals and connecting regional and shortline railroads to be identified and submitted in the same form as the major city information.

- Both the benchmarked and proposed post-merger submissions to include the through schedules of other connecting Class 1 railroads.

It would be unrealistic to ask a merger proponent to identify every service schedule for every movement. However, the intention is to develop enough meaningful information on service pre- and post-merger to quantify the service changes that will occur as a result of the proposed merger. This submission should also provide support for the logic of the proposed service schedules, and would serve as the benchmark for measuring deterioration of service. See the discussion at page 22.

FGLK believes that a review of the operating plan, including the service benchmarks described above, would best be addressed through the proposed Merger Review Team. The team would be responsible to assess at a minimum:

- The overall ability of the applicants to implement the proposed service plan.
- The adequacy of operations infrastructure to support the operating plan.
- Line capacity issues and constraints.
- Train dispatching issues and constraints.
- Placement of appropriate managerial staff to support the operating plan.
- Quality and quantity of train crews to support the operating plan.
- Understanding of applicant personnel of the operating plan implementation, down to the trainmaster level of supervision.
- Adequacy and reliability of electronic data and computer systems required to support the operating plan.
- Adequacy of equipment supply to support the anticipated volumes of business.
- Applicants' financial ability to support any changes required in the operating plan.
- Reliability of the proposed "backup" plan if systems begin to fail.

Overall Service Value

Generally, railroad service is much longer than that for truck delivery of products.[8] As such, the typical quid-pro-quo between customer and railroad is for the railroad to offer a lower price to compensate for the longer delivery time. Unfortunately this has placed the railroad industry in a position of selling price and not service. Customers are often willing to accept longer transit times in exchange for a lower price. We find that customers generally are more concerned with regular and consistent rail service as opposed to speed. However, there is a limit when longer transit times translate into ineffective value.

8 It probably shouldn't be, because Class I railroads can travel as fast as trucks do on the interstate highway system, and railroads have generally quicker access to the downtown locations of the nation's major cities.

In its experience, FGLK has found that customers no longer consider rail service of any benefit if the mean transit time of their rail shipments exceeds 14 days. This does not appear to be an arbitrary limit, but is based on a combination of the maximum lead time a customer can allow its vendors to supply raw material, and the maximum window it can provide its customers to supply the product. Bottom line, we find that if rail service falls outside the 14-day window, you are "off the radar screen" with the customer, and the service essentially has no value at any price. FGLK is concerned that, as an industry, railroads are dangerously close, and is some cases now exceeding, that point. For those industries where the economies of scale and distance favor, the rail, there is a real public interest concern. This can translate into higher raw material costs and higher product delivery costs based on the other available transport alternatives. This in turn can impact the economic viability of the affected business, and the community in which it operates.

Merger-related service problems in the last several mergers approved by the Board have adversely affected both the length of time and the consistency of traffic handling. As discussed above, both of these have serious implications for shippers, and negatively impact their choice of whether to use rail service. Shortlines will of course be affected by the choice of shippers to use other modes of transportation, even thought the service problem was not of their making. Further, where service has gotten backed up on Class Is involved in mergers, they have had to transload traffic around various "choke points." Transloading solves a shipper's immediate problem, but often eliminates the haul by the shortline, eliminating the revenue that the shortline would have earned but for the service problems of the connecting Class I. As discussed further on page 22, shortlines should be compensated for this loss of revenue.

There is a real public interest concern about potential service disruptions that the Board should carefully consider in its review of merger applications. Again, the Board should facilitate and encourage solutions to these problems, as in the end; railroad customers will benefit from more valuable and competitive services.

Equipment Supply

Mergers are usually promoted as providing more efficient service and being more market focused. But applications do not address issues that may prevent these goals, such as car supply, car utilization and material handling. All three of these drive efficiency and pricing. Applicants should be required to discuss in their applications whether they have an adequate car supply available to handle projected business volumes, how car utilization will be improved through, for example, new backhaul opportunities, and how they propose to improve material handling.[9]

Applicants should be able to demonstrate that they will have an adequate equipment supply to support their projected business volumes, and that they will have the economic viability to replace rail car equipment fleets in the future. Car supply is a very important issue with shortline and regional railroads that depend on a cost effective and adequate supply of freight car equipment for customers, especially for the boxcar. This issue takes on additional significance when service problems translate into decreased car utilization, and increased rates for customers.

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[9] These issues are discussed in more detail at pages 31-34.

Shortline and Regional Railroad Issues

Shortlines and regional railroads provide essential services and value to railroad customers, and its connecting Class I service partners. In appearance, shortlines are actually like one large customer to a Class I. Many shippers and receivers depend upon the services that shortline and regional railroads provide, and the number of shortlines continue to grow in the U.S., Canada and Mexico. We believe that the value that shortlines represent in the industry was never stated better than in the comment submitted to the Board by Mr. Roy Nott, President & CEO, Paneltech International LLC Hoquiam, WA.[10] We quote:

> We have talked about "end-to-end" connections. Let's now talk about "side" connections. We also rely extensively on shortlines to serve these small, out of the way facilities and timberland ownerships. Shortlines require switching fees but they generally move faster than the Class I's which helps to offset these incremental costs. It is tempting for them to exploit what are often near monopoly positions (and they sometimes do) but it is really in their long term interest to learn their local customers' businesses and to become their "partners" and advocates with the Class I's they both rely upon. A small mill or independent timberland owner could not have a better friend than a cooperative and well-managed shortline. They are more entrepreneurial, they are more accessible, they better understand the strange internal workings of the big railroads and they really act as if they believe that they succeed or fail with the success or failure of their customers. They are perhaps our best agents for ensuring that the major railroads really compete with the only real current alternative in most situations - long haul trucks.

FGLK fully supports and endorses the "Bill of Rights" advocated by the American Short Line and Regional Railroad Association in its March comments.[11] FGLK does believe that

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[10] Public Views on Major Rail Consolidations, STB Ex Parte No. 582, "Paneltech - A Western Log Shipper's Perspective."

[11] Public Views on Major Rail Consolidations, STB Ex Parte No. 584, "Statement of Frank K. Turner, President, American Short Line and Regional Railroad Association."

the Bill of Rights should be recognized by the Board as valid concerns of shortlines, and included as part of the requirements that the merger proponents must address in their application. This provides the merger applicants the widest latitude to address "up-front" the issues at hand. However, the Board should reserve the right to impose one or more of the Bill of Rights elements as a condition of merger. FGLK offers the following specific views as to how the applicants should address each of the elements of the Bill of Rights:

The right to compensation for service failures

If service is reduced to the point that customers must truck their products to avoid unreliable rail service, or car supply is substantially interrupted by service delays, the shortline loses valuable cash flow and revenues that it relies upon to provide a dependable service and maintained plant. Toward that end, if the service of a merged carrier degrades to the point that the affected shortline's customer must use an alternative mode, such as trucking, to protect its interests, the affected shortline should be entitled to its lost carload revenue as compensation for such service failures.

Additionally, the car hire costs of shortlines can be substantially increased because a customer elects to receive product by truck due to service failures. For example, a customer orders trucks and fills its silos with product. Then a multiple number of cars delayed or "bunched", due to service problems, are interchanged to the shortline for which the customer cannot take delivery because the silos are filled. The recourse for the shortline is to place the cars on demurrage, but the customer refuses to pay, because of the poor service and "bunching" of cars. This leaves the shortline "holding the bag" for the car hire costs. We believe that shortlines should be entitled to recovery of the additional car hire costs incurred due to unreliable service.

<u>The right to interchange and routing freedom (including the elimination of so-called paper and steel barriers)</u>

FGLK believes that so-called paper and steel barriers should be removed if a merger is approved under 49 CFR 1108.2. These barriers are usually constructed as agreements imposed by a Class I railroad when divesting a portion of its trackage to a shortline. In that context, such agreements may have some merit. The motivation and value for sale or lease of properties by a Class I to a shortline is to obtain cash for its assets, reduce terminal expenses, and yet retain the former flows of carload business. Prospective shortlines can benefit from these arrangements by lowering the sale price for assets acquired. Shippers can also benefit; by having a reliable service carrier in place for a line that otherwise might be an abandonment candidate. However, the value realized between the parties in their sale agreement ends with the consummation of the sale. Going forward, (and especially in these times with so few Class I railroads) a merger of Class I railroads will substantially change the competitive playing field. By any standard, the approval of a Class I merger in today's environment will provide the newly merged Class I with even more significant market power. With the merger, the original motivations of the selling Class I in protecting its business interest disappear as the global playing field is enlarged. The newly merged carrier should have sufficient pricing and service leverage to entice customers located on the shortline to use its services without having to rely on artificial barriers. Thus, if shortlines have interchange or other competitive outlets available, they should be allowed to use them.

The right to competitive and nondiscriminatory pricing

As stated previously in the section relative to competitive harm as applied to shippers, shortlines should have similar standing before the Board. If a carrier is offering prices and services into the market and refuses to offer the same price under the same conditions to other market participants, the shortline should have standing before the Board for the review and remedy of carrier practices.

The Merger Review Team should also review the general pricing and commercial practices to be employed by the newly merged carrier with respect to shortlines. Of particular concern is so called "Rule 11" or differential pricing when the Class I declines to absorb all or part of a shortline's charges and forces a shortline to add-on a charge to the price at interchange, or requires publication of a higher through rate with the shortline. This is especially troubling when the terminated price at a Class I served location is the same as the delivery price for movement beyond the interchange point to a shortline. In essence, the shortline's Rule 11 price becomes an "up-charge" to the rate, discouraging customers from using the shortline.[12]

A further concern for shortlines in future merger considerations is the potential for discriminatory pricing between 286 and 263 cars that could be prejudicial to shortline customers. In fairness, the Railroad Industry Agreemen[13] between Class I railroads and shortlines has been a initial step to address this concern. However, going forward there will be continued pressure on costs, equipment utilization and the desire of shippers to reduce the size and investment in

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[12] In fairness however, the shortline's compensation for a movement it handles must be reflective of the competition and reasonable with respect to the services it performs.

[13] Class I / Shortline Railroad Industry Agreement, September 1998.

private car fleets that could cause concern in future merger considerations. Applicants should be required to address how they will handle this issue with their shortline connections.

The right to fair and nondiscriminatory car supply

Car supply is a cost that is essentially treated as a net add-on or discount to freight pricing. As such, rail carriers maintain separate rates that break down into two subdivisions: rates for railroad-supplied cars and for shipper-supplied cars. The shipper car rates are discounted to incent the customer to acquire its own equipment. The Merger Review Team should examine the carrier practices of its equipment allocation to ensure that the newly merged company will distribute railroad-supplied equipment fairly and equitably amongst all parties.

There are several areas that impact the resolution of nondiscriminatory car supply issues that will impact the car supply policy of merger applicants which the Board may desire to visit in the public interest. For example, many shortline sale agreements included provisions that the Class I is solely responsible for car supply, and the shortline is prohibited from acquiring its own equipment. This may have been reasonable at the time the line-sale transaction was consummated, but over time conditions change. A surge in equipment demand may strain the available equipment supply, or new markets can emerge that increase the demand for equipment. If a Class I carrier cannot deliver an adequate supply of equipment, the shortline should be free to develop its own source of equipment. (However, the cost of such equipment to the Class I should be proximately equal to the cost of the equipment it otherwise would have supplied.) Similarly, if shippers desire to provide equipment for movements that the Class I carrier cannot provide, the OT-5 application that the shipper must file for permission to use private cars should not be denied.

Merger-Related Public Interest Benefits

The Board has asked for comment on how claims of public interest benefits should be treated under its merger rules, including how alternatives to merger should be considered in this context. Public interest claims should be at least quantifiable if not measurable. In that context, FGLK believes that the Board should request applicants to support claims of public interest benefits with more specific detail as discussed above, and through support by the public at large, state and municipal agencies or other agencies and interests that can attest to the claimed benefit. Perhaps the Board might require merger applicants to submit an appendix listing of claimed public interest benefits, so that interested parties may otherwise comment on the pros and cons of the claimed public interest. This would provide the Board with a definitive location in the application from which it may decide if the merger applicants have shown sufficient public interest benefits to justify approval of the transaction.

Cross-Border Issues

The Board has asked for comment on how its merger rules should address various concerns regarding potential harm to American interests that might result from the merger of a Canadian railroad and a large U.S. carrier. This will be a more difficult issue for merger applicants as they would be required to observe the laws applicable in both countries to obtain merger approval.

The Board can be more active in developing the criteria for such mergers through resolution dialogue with the appropriate governmental authorities of other countries such as Canada and Mexico. Those countries will have similar concerns regarding a U.S. railroad merger applicant. Ultimately the Board will determine where the bounds of protecting the U.S. public interest are. However, if international agreements on issues can be resolved in advance, it will make the approval process that much easier.

Other Areas That Affect Public Interest

The Board has also requested public comment any other ways in which its merger regulations should be modified to promote and enhance competition and/or other public interest goals. There are a number of industry issues that, while possibly not directly involved in the merger, will affect the planning of the merger and the evaluation of its likely outcome.

Overall Public Interest

Beyond specific public interest issues that are raised in consideration of any merger application, the Board should also consider the broader issues of how collateral interests will impact railroad mergers of the future. The majority of large industrial companies in the U.S. rely on a dependable and cost effective rail service to receive raw materials and move finished products to market. Competing succesfully for global market share represents strength and vitality for the U.S. economy. Therefore, the vision of America's future rail system must include innovative, competitive and valuable rail services that customers can use in their quest for that expanded market share.

The Future Need for Capital

Until 1980, the railroad industry was essentially in a state of "managed decline", culminating in the eventual bankruptcies of several large railroads. The Staggers Act of 1980 finally established a free market system that allowed railroads to tailor prices for the services offered.

Most important is the period between 1980 and 1995, a time of significant reduction in the railroad costs due to plant rationalization and a concomitant increase in productivity. Plant rationalization included divestiture or abandonment of lines and internal infrastructure such as yards, passing sidings and double-tracked main lines. Many of the nation's shortline and regional railroads were carved from the Class I railroads during this period. This downsizing, along with increased business volumes realized under the free market benefits of the Staggers Act, allowed railroads to more closely match costs to revenue.

By 1995, most of the productivity gains and cost reduction benefits had been extracted from the system, and looking forward, the industry could only expect much smaller cost reductions and productivity gains. However, the rail industry was still not earning its cost of capital, and was faced with the dilemma of either further reducing costs or significantly increasing its business volumes to justify the additional infrastructure to support the increased business volumes.

Therefore, merger becomes an attractive option to increase efficiency and improve service. There is a danger however, and that is the notion that one can merge their way to economic prosperity. For a merger to be truly beneficial and in the public interest, it must realize the announced benefits and in particular the promised service benefits.

Volume growth of business for all railroads, and especially Class I railroads, is not only an objective, it is an imperative. The railroad industry has been operating under a system of either "managed decline" or cost reduction for years. Now, for continued survival, railroads must shift to a business growth mode. This will take significant amounts of investment capital. To a large extent, the railroad industry will need to reinstall much of the infrastructure that was dismantled in the 1970s and 1980s. Applicants should be required to disclose in their application their plans for improving facilities and making infrastructure improvements to grow the business.

Given the need for capital to fund these infrastructure improvments, Wall Street will play an ever increasing and important role in the shape of railroading for the future. However, Wall Street tends to focus on short term returns – cutting expenses, people and infrastructure. This may help the bottom line in the short run, but makes integration and growth that much more difficult to achieve. Thus, the Board in reviewing merger applications should ensure that the applicants are looking towards long term growth and provide the infrastructure to support that growth. The focus cannot be solely on the short term in order to satisfy the money managers. Ultimately, it is growth in business that will make the railroads more profitable, and shippers more satisfied

<u>The Wall Street Factor</u>

In a recent article published in Railway Age,[14] James Valentine, a managing director a Morgan Stanley Dean Witter, said, "The real question is, can railroads earn their cost of capital?" ("Wall Street and ...", at 34.) In the same article, Gentry Lee of Fayez Sarofim & Co, Houston, TX states "In the long run you better earn your cost of capital or people won't provide it to you." ("Wall Street and ...", at 34.) Class I railroads generally are still are not revenue

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[14] Kaufman, Lawrence. "Wall Street and the railroads: Who's in charge?" <u>Railway Age,</u> February, 2000, at 29-36.

adequate,[15] and this represents a downstream public interest issue if Wall Street is unwilling to provide capital funding for the infrastructure improvements, merger or otherwise, in the future.

The same article suggests that "Over the long term, the interests of owners and customers coincide. Both have an interest in providing quality service at competitive prices – and profitably." ("Wall Street and ...", at 29.) We have to ask however, is Wall Street actually "walking the talk". (Indeed, it is interesting to note in reviewing the list of parties to this proceeding the absence of any Wall Street firm desiring to make comment, despite that significant amounts of capital will be required to realize the full benefits of future mergers.) It appears that the first suggested solution to falling carrier stock prices is the suggestion of cutting expenses. If the interests of Wall Street and customers are truly convergent, then there should instead be a call for improved services that will generate greater customer satisfaction and increased business volumes, which, in turn, generate greater profitability and shareholder value.

Property Tax Issues

FGLK also believes that that the Board should review the investment plans as set forth in merger applications to see if state property taxes have been taken into account. Tax schemes vary greatly from state to state, and they can have a substantial impact on proposed capital plans. A tax policy that places significantly disproportionate assessments on rail property as compared to other businesses in a community can have a devastating impact. (For example, some states use the current reproduction cost of an asset less depreciation in arriving at rail property assessment values.) This valuation process substantially increases the property

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[15] At least under the Board's current standard. See STB, Ex Parte No. 552 (Sub No.3), Decision (served September 1, 1999).

assessment and resulting tax liability of the railroad. By comparison, the valuation process for most other business and real property in the same community is based on the market valuation of the property. A rail carrier faced with the prospect of high taxes, on unused land or assets, will be forced to consider selling the land or removing the infrastructure to reduce its tax liability. States and municipalities where railroad property is heavily taxed will find that rail carriers are less inclined to add infrastructure or make improvements. The fact that tax policy can shape a proponent's merger so as to promote inefficient or ineffective investment, and more circuitous routing of freight, should be a particular public interest concern to the Board.

The Board should also consider the overall impact of inequitable taxation as it relates to the railroad industry's ability to earn its cost of capital. As stated earlier, this is a particular concern of Wall Street and the industry overall. This will have a bearing of the nature structure of future mergers, and ultimately what rail customers pay for carrier services.

It is important to note however, there can be a real quid-pro-quo benefit to states and communities where railroad tax policies and issues have been resolved. When shippers and rail carriers alike make investments that attract new business, or expand the activity of existing businesses, employment increases and thereby generates "downstream" community benefits in the form of a more productive industrial and retail economy that is clearly in the public interest. The Board should consider tax policy as it affects railroad merger proposals and the railroad industry in general.

Freight Car Utilization and Contribution.

Shortlines depend heavily on the standard freight car (box, hopper, gondola, flat and tank). During the 1980s and 1990s, there was a large surplus of these cars. That surplus has now vanished, and traditional freight equipment is becoming increasingly limited in supply. This fleet which is most suitable for the general merchandise traffic typical of most shortlines, is rapidly aging and deteriorating. A major industry concern is the ability to generate the return on investment required that will justify equipment reinvestment. We know of four ways to enhance the economics of carrier investment:

- Improved utilization - by minimizing dwell and transit time to increase monthly cycles of a car and thereby raise its profit contribution.
- Increased contribution - by obtaining revenue producing headhaul / backhaul traffic that somewhat lengthens the utilization cycle, but vastly increases the carrier's profitable revenue contribution per car.
- Improved car hire / mileage payments – by negotiating higher hourly or mileage related fees collected by owners for off-line car use.
- Increased Rates – by increasing freight rates to elevate the contribution per car.

Of these options, better utilization, increased rates, and to a lesser extent increased car hire and mileage payments are the tools most often used to develop adequate levels of car revenues to justify equipment reinvestment. Increasing contribution through the use of backhaul pricing methodologies is in far less use and should be encouraged more. Backhauling of equipment or equipment triangulation focuses on the loaded (revenue paying) miles of a car. Several short distance loaded car movements in a month can add up to more revenue than one long haul. More importantly, rail carriers could be better competitors for short distance movements under 300 miles. Most importantly, rail carriers would be meeting their truck competition head on, in that most motor carriers run loaded well over 90 percent of the time. In contrast, railroads are lucky to run loaded 50 percent of the time.

Since 1985, shipper ownership or leasing of cars has sharply increased, while carrier ownership has sharply decreased.[16] Carriers are providing price incentives for shippers to defray the cost of equipment ownership or leasing. But equally important is the ability of shippers to partner with rail carriers for headhaul and backhaul utilization of equipment. While this is not possible for all car types where product integrity and contamination is an issue it is possible for many commodities in shipper supplied cars such as ground minerals, where a "sweep out" of the car is needed for use in backhaul service. Such partnerships between railroads and its shippers can provide the benefit of improved revenue contribution for carriers and significantly lower prices for shipper's product through the use of their cars in backhaul movement. Carriers and shippers should be encouraged to collaborate in the effort to stimulate increased contribution through the bi-directional use of shipper supplied cars, and applicants should describe opportunities for such movements in their application.

Utilization is also affected by AAR Car Service Assessment Orders CSD 145, 155, 150 and 435 that require cars to be returned empty to the loading point. FGLK believes the Board should carefully review these rules, as they discourage loaded bi-directional use of equipment. Such bi-directional use can be an advantage in broadening the supply of cars generally available. In addition, bi-directional loading of cars is a superior way of increasing freight volume without materially affecting line capacity, as the car that would be returned empty via the reverse route will now be returned loaded. With the technological advances in computerization, many railroads are using a system of internal "default assignment". Under this system, rail carriers can load cars generally without restriction. However, if a car becomes truly

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[16] AAR /Policy, Legislative and Communications, Progressive Railroading (pp.52), May 1999.

surplus at any time, it is directed to a default "home" location that reflects a system point where the car can be reloaded by an active shipper. In this context, the car is never actually "forced" into required empty return status.

Material Handling.

An area that has received little attention is in the material handling capabilities of railroads. Significant dollars are spent through public and private funding for research of mechanical and track improvements and efficiencies. Boxcars come in varying lengths and heights, so the railroad customers typically must use void filling devices, 2 x 4 blocking and bracing, and air bags, to ensure damage free delivery of products. The use of this extra "dunnage" can add a cost of $200 - 300 per shipment, which must be compensated for by the railroad in its price offering. Trucking companies, on the other hand, have intensely focused in this area. For example, the trucking industry has standardized the size of its trailer equipment, and its customers use the 40" x 48" grocery pallet almost universally, which fit neatly inside the trailer. Therefore, trucking companies do not have to discount their price.

Another example of boxcar use inefficiency is in the shipment of beer and wine. The insulated box cars typically used for these movements have a net carrying capability of 70 tons. However, shipments of these products only average about 50 tons per car due to the customer's reluctance to double-stack product at the risk of damaging the bottom cases. Solving this issue will add 40% greater payload capacity in the car. Multiplied over many shipments, this represents the availability of significant additional national boxcar capacity at a time when such cars are in very short supply. It also provides a revenue stream sufficiently adequate to justify equipment reinvestment, which has been limited for this car type in recent years.

Impacts of 286,000 lb. vs. 263,000 lb. Gross Weight On Rail

Another area that will affect mergers is the impact of the new "286" rail equipment that is quickly becoming an industry standard. The use of 286 equipment has several implications for shippers, Class Is and shortlines. We don't presume to know all there is about these issues, but have tried to provide our perspective of how we feel the impact of this technology will affect some of the stakeholders as follows:

Shippers - Shippers will likely view the 286 car as a means of reducing the number of cars required and product transportation costs, and will desire to maximize the transportation savings that can be realized through the use of such cars. To the extent that shippers rely on shipper-owned or leased cars, the greater carrying capacity will have an immediate impact on the size and overall cost of private car fleets.

Class Is - Class I railroads will also see cost savings benefit in using 286 cars. The majority of their track structure has been upgraded to accommodate 286 cars. Much of this was motivated by the desire to fully achieve the carrying capacity for double-stack containers in intermodal services, but there are also cost saving advantages for many of the unit train operations. This now has "spilled over" into the merchandise business sectors and it is clear, in time, that the 286 car will be the new industry standard. Indeed, we believe that all new rail equipment is currently being built for 286 capability.

Shortlines - The impact for shortlines is entirely different. Many shortlines continue to struggle with the maintenance of an adequate 263 plant much less improving to 286. Also, few shortlines have a core revenue stream that will justify the leap to 286. For most shortlines it is not a case of collateral benefit, but more one of direct cost. FGLK estimates that, just for track, upgrading costs will increase its maintenance of way budget by 5% – 10%. If a major bridge structure needs upgrading, it will likely be outside the economic means of most shortlines to make the improvement. Additionally, there will be a special impact on shortlines that get paid a per-car fee. Not only will it not necessarily receive additional revenue for handling the heavier cars, but if the number of cars that it handles is reduced, it may actually earn less revenue.

A more immediate issue is the use of 286 cars on 263 track. For example, the tare weight of a 263 car is about 63,000 lbs. leaving a net weight carrying capacity of 200,000 lbs. to stay within standard. The tare weight of a new 286 car can be as high as 76,000 lbs. With a gross weight capacity of 263,000 lbs., the net weight carrying capacity is 187,000 lbs. This means that such 286 cars will have a 13,000-lb. inefficiency when operated on 263 track, as compared to cars designed for 263 operation.

VERIFICATION

I, Michael V. Smith, President of Finger Lakes Railway Corp., verify under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file the foregoing Comments.

Executed on May 15, 2000.

Michael V. Smith

Appendix A

Map

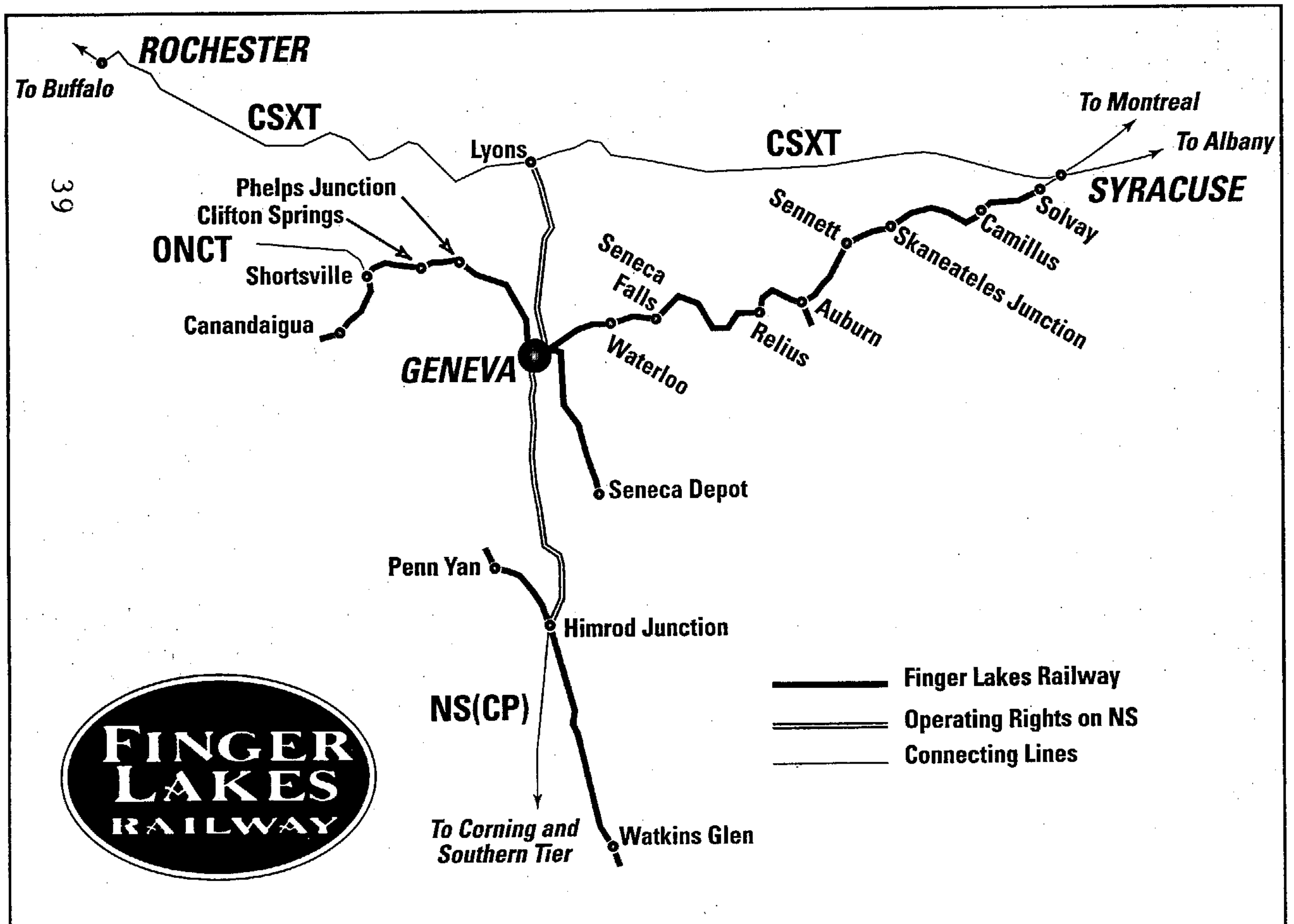
Rail/Highway Transfer

FGLK is strategically located near the New York Thruway between Syracuse and Rochester, a logical area for rail/highway transloading and distribution. Our marketers are experts in matching up the cost benefits of long-distance shipment in carload lots with the service flexibility of local trucking. Proximity to a rail line is not necessary to take advantage of favorable rail transport economics. We will make arrangements with trucking companies to use either public terminals or dedicated facilities as rail/highway transfer points.

Industrial Development

FGLK's accessibility to major U.S. and Canadian metropolitan centers via three Class I railroads makes the communities it serves highly desirable locations for manufacturing, processing and distribution facilities. New York State has become very aggressive in revitalizing its industrial base. FGLK works closely with State officials and county Industrial Development Agencies to attract and expand businesses which will diversify the regional economy and increase employment opportunities. Rail service flexibility was an important consideration in locating New York's largest development project in two decades on FGLK at Geneva in 1998.

System Diagram



Physical Facilities

FGLK's main-line track and roadbed are maintained to strict Federal Railroad Administration standards and have no unusual weight or clearance restrictions. We are committed to regular investment in the fixed plant, and continuing improvement programs assure our ability to handle traffic safely and reliably.

Finger Lakes Railway Corp.

Miles	Stations and Facilities	
0.0	Solvay (CSXT)	I-P-T-Y
0.6	Fairmount	
4.9	Camillus	D
13.7	Skaneateles Junction	
17.4	Sennett	
22.5	Auburn	P-T
28.0	Relius	
37.5	Seneca Falls	P
40.0	Waterloo	
47.0	Geneva	I-P-T-Y
57.4	Phelps Junction	
60.2	Clifton Springs	
64.4	Shortsville (ONCT)	I
70.4	Canandaigua	D-P-T
0.0	Geneva (NS,CP)*	I-P-T-Y
14.7	Lyons (CSXT)*	I
0.0	Geneva (NS,CP)	I-P-T-Y
13.5	Seneca Depot	D-P-T
0.0	Geneva (NS,CP)*	I-P-T-Y
22.0	Himrod Junction*	T
27.4	Penn Yan	D-P-T
35.5	Watkins Glen	

Reference:
D Distribution center
I Interchange track
P Industrial park site
T Team track
Y Switching yard
*Connected via operating rights, Lyons-Himrod Junction.

FGLK is a member of the American Short Line and Regional Railroad Association and a supporter of "Operation Lifesaver," the national campaign to improve grade-crossing safety.

CERTIFICATE OF SERVICE

I hereby certify that on this date a copy of the foregoing Verified Comments of Finger Lakes Railway Corp. was served by First Class Mail, Postage Prepaid, on all Parties of Record.

Dated: May 16, 2000

ERIC M. HOCKY